1. Country and Sector Background

Indonesia has shown solid progress in economic growth and poverty reduction since the Asian crisis 12 years ago and has demonstrated sustained resilience and robustness during the recent global economic downturn. Poverty rates have fallen from 17.4 percent of the population in 2004 to 14.2 percent in 2009. Despite these gains, 32.5 million Indonesians currently live below the poverty line and 40 percent of households live just above the national poverty line of US$21 per month and remain vulnerable to falling into poverty. Poverty is particularly high in rural areas, where about half of the population and more than two-thirds of poor people reside. Non-income poverty remains a serious problem in terms of indicators related to health, access to safe water and sanitation, and education outcomes. Inequality is increasing as evidenced by a Gini coefficient of 31.7 percent in 1999, which has risen to about 35 percent in 2009.

In August 2006, the Government of Indonesia (GOI) launched its flagship community-based poverty alleviation program, the National Program for Community Empowerment or Program Nasional Pemberdayaan Masyarakat (NCEP/PNPM). PNPM is the Government of Indonesia’s (GOI) operational umbrella for all poverty programs which use a community empowerment approach. The objective of PNPM is to ensure that the poor benefit from improved socioeconomic and governance conditions. The program aims to consolidate community-based programs of various ministries and institutionalize Indonesia’s experience in bottom-up planning and decision-making into a single community-based poverty reduction program, in both rural and urban areas. PNPM is one of the largest poverty reduction programs in the world, with a documented record of community engagement, participation, and service delivery. Today PNPM has nationwide coverage in all rural villages and urban wards in Indonesia. The program’s participatory and transparent framework has helped improve local governance by directly
involving communities in decision-making and has been successful in increasing the poor’s (including women and vulnerable community members) access to tertiary socio-economic infrastructure and other basic services.

PNPM has a rural and urban arm and builds primarily upon the successful experience with the Bank-funded Kecamatan Development Program (KDP1, KDP2, KDP3, KDP3b and the Community Recovery through KDP in Aceh and Nias) and the Urban Poverty Program (UPP1, UPP2, UPP2 Additional Financing, and UPP3), which began in 1999. Since the first KDP/UPP projects in 1999, each successive project has built on the lessons learned from previous projects. Although PNPM is designed as a consolidated poverty reduction program, GOI maintains separate rural and urban windows for implementation. The implementing agency for the rural arm of PNPM is the Ministry of Home Affairs (MOHA), while the implementing agency for the urban arm of PNPM is the Ministry of Public Works (MPW). This is due to the scale and scope of the PNPM, the oversight of different ministries, and the operational differences tailored to the rural and urban contexts. However, the convergence of systems continues at the village level and additional opportunities for common implementation strategies were identified during project preparation – such as operational procedures regarding procurement; monitoring and evaluation; complaints handling; anti-corruption; and the training of the programs’ community facilitators. Standardization of many fiduciary aspects concerning supervision of the two programs was also incorporated into the respective designs of PNPM-Rural and PNPM-Urban. These include a common financial management and auditing framework; shared sanctions protocols; a consistent financing framework; and harmonization of the procurement rules for community-driven development (CDD) projects.

In 2009, a massive scale-up of the entire PNPM program occurred resulting in PNPM-Rural covering 68 percent or 4,371 of the sub-districts (kecamatan) in Indonesia (4,371), comprising approximately 59,166 villages. A key component of PNPM-Rural’s poverty reduction and local governance effort is the disbursements of block grants to Indonesia’s rural administrative sub-districts. Through a gender-inclusive participatory approach, community representatives residing within the sub-districts determine the specific tertiary socio-economic infrastructure projects the block grants will fund. Annually disbursed sub-district block grants will range in size from Rp. 900 million to Rp. 3.0 billion (approximately US$90,000 to US$300,000) per sub-district depending on individual sub-district population, remoteness, and indicative level of poverty.

The Bank has provided critical financial and technical support to UPP/KDP/PNPM. Since the first KDP project that was operational from 1998-2002, several successor projects have been approved by the Board and are under implementation. In 2008, the Bank approved the first PNPM-Rural project and subsequent Additional Financing in 2009. The majority of funds have supported small-scale infrastructure construction and maintenance. The program has reached 4,371 or 68 percent of the sub-districts in Indonesia.

2. Objectives

PNPM’s overall objective is to reduce poverty and improve local-level governance in Indonesia through the provision of investment resources to support productive proposals developed by communities, using a participatory planning process. PNPM-Rural’s project development objective is for villagers in PNPM-Rural locations to benefit from improved socio-economic and local governance conditions.

The project is consistent with the FY2009-12 Country Partnership Strategy (CPS) for Indonesia, Investing in Indonesia’s Institutions for Inclusive and Sustainable Development, which emphasizes engagement with government counterparts, including at the sub-national level, and other stakeholders to address critical governance and institutional challenges. The project’s CDD approach aims to improve existing
government programs, strengthen institutions and improve the links between different levels of government. In addition to its cross-cutting engagements to strengthen central and sub-national government institutions and systems, the CPS identifies five thematic areas, which form the core of the Bank’s engagement: (a) Private Sector Development; (b) Infrastructure; (c) Community Development and Social Protection; (d) Education; and (e) Environmental Sustainability and Disaster Mitigation. The proposed project supports both the approach suggested in the CPS as well as its thematic areas of engagement. PNPM serves as the Bank’s operational centerpiece for community development.

3. Rationale for Bank Involvement

There are multiple reasons for continued Bank involvement in PNPM, including its (a) successful track record working with GOI to manage and execute the KDP projects and ongoing PNPM-Rural operations; (b) readiness and ability to provide necessary technical expertise in required areas; (c) early intervention in the form of additional financing for innovations and assistance in program development; (d) strong mechanisms in place to facilitate project supervision, results monitoring and evaluation, quality control, and targeting; and (e) capacity to assist GOI in synergizing the participation of development partners supporting PNPM. In addition, through the PSF, the Bank is uniquely placed to support GOI to develop and institutionalize the PNPM framework and the development of its long-term poverty reduction strategy. Bank involvement also promotes better capture of synergies between PNPM community investments with other sector projects and in increasing the active involvement of sectoral departments and local technical agencies in service delivery. Another reason is that the Bank can also leverage its institutional experience and knowledge of global best practice of large-scale, national CDD programs in Brazil, India, Mexico, and the Philippines, to name a few.

The rationale for the Bank’s continued involvement in and support of PNPM-Rural is based on the achievements made through the KDP and PNPM-Rural series of projects, including:

(a) Poverty reduction: A rigorous 2008 impact evaluation of KDP2 (PNPM-Rural’s direct predecessor) showed that real per capita consumption gains were 11 percent higher among poor households in KDP areas compared with control areas. Also, the proportion of households moving out of poverty in poor sub-districts was 9.2 percent higher in KDP2 areas compared with control areas. Vulnerable households near the poverty line were less at risk of falling into poverty as a result of KDP participation. An impact evaluation of KDP1 shows that the program had a significant impact on rural household expenditure; the longer a sub-district received KDP funding, the greater the estimated impact on rural household expenditure.

(b) Employment: KDP reduced unemployment by 1.5 percent in comparison with control areas. Some 72 million workdays have been created as of December 2007 from KDP/PNPM-Rural.

(c) Physical village infrastructure: As of September 2009, over 53,000 kilometers of roads have been built or upgraded; 11,600 clean water supply units built; 13,300 irrigation systems built, 6,000 village health posts supported; and 9,700 schools have been built or rehabilitated, along with other types of economically productive infrastructure since KDP1 began in 1998. Subprojects funded through KDP have resulted in expanded business opportunities and employment. Economic rates of return on sample infrastructure are high, ranging from 39 to 68 percent.

(d) Quality, cost-effective infrastructure: Independent evaluations of the technical quality for infrastructure built classified over 90 percent of the infrastructure as “good” to “very good”. Also, an independent evaluation found that village infrastructure built by villagers through
KDP/PNPM costs significantly less—on average 56 percent less—than equivalent works built through government contracts.

(e) Participation rates: Community participation is high. Participation of women in PNPM-Rural meetings averaged 48 percent in 2008. Nearly 60 percent of those who attend KDP/PNPM-Rural planning meetings are from the poorer segments of the community. A recent impact evaluation and gender review did find, however, that PNPM could do more to promote participation of women and vulnerable groups.

(f) Health and education benefits: PNPM-Rural and its health and education pilot program, PNPM-Generasi have led to school facility improvements and reduced school costs for poor families. In addition an interim impact evaluation shows that PNPM-Generasi has dramatically improved healthcare access and use, including a strong rise in the number of mother and children using healthcare services; lowered malnutrition rates in areas indicative of chronic malnutrition; and increased working hours of and out-reach services provided by midwives.

4. Description

The project will cover approximately 420 additional sub-districts, which were recently created by the administrative division of sub-districts and their subsequent incorporation by GOI into the program. It will also continue to support those 4,371 sub-districts already which are participating. The project will utilize the institutions established and processes and mechanisms developed under the first PNPM-Rural project and its predecessor KDP projects, building upon experience gained and lessons learned. The four components will be similar to the ongoing project. Table 3 below illustrates project costs by component and by IBRD and government and community contributions.

Component 1: Kecamatan Grants (US$1,186.82 million). The main activity in PNPM-Rural III, similar to PNPM-Rural and Rural II AF, will be the construction of economic and social infrastructure that is needed and requested by the target communities. The selection of activities is open except for items specifically excluded through the project's negative list, or for land purchases of any kind. These activities are funded through grants disbursed by the government to the sub-districts (kecamatan) and villages.

While project will also continue to support revolving funds managed by women's groups efforts will be focused on promoting more sustainable access to financial services to the poor, while at the same time maintaining and improving community ownership. Up to 25 percent of the block grants can be used to support women’s saving and loans groups through revolving funds. Under PNPM-Rural approximately between 16 to 18 percent rather than the eligible 25 percent of block grant funding was in the form of revolving funds. The average repayment is about 94 percent. If any sub-district falls below 80 percent the window closes and revolved funds are not allowed. Discussions with GOI on a multi-year pilot for access to financial services to the poor, especially targeting women beneficiaries, are currently underway. Presenting details on the best approaches to ensure the financial sector can play a more active role in expanding the poor’s access to sustainable financial services will be part of the pilot’s work.

There are also a number of special initiatives that can be funded using the block grant disbursement mechanism provided certain procedural changes are made to the standard PNPM-Rural Project Manual and complemented by additional facilitation and technical assistance. They include inter alia:

(a) Responding to crises, including natural disasters, financial, and special needs in border areas, where an accelerated planning and disbursement cycle is allowed; and
Supporting community investments that are environmentally friendly, including investments in renewable energy, in particular micro-hydro power.

In addition to the core sub-district planning and block grant scheme, PNPM-Rural has operational pilots funded through loans and grants from several bilateral development partners (Australia, Canada, Denmark, The Netherlands, and United Kingdom). The pilots build upon the main PNPM platform and principles of community participatory engagement. Two of the major pilots are:

(a) PNPM Generasi or the incentivized block grant scheme for the achievement of MDGs related to health and education; and

(b) Green PNPM to support natural resource management and renewable energy initiatives.

Component 2: Facilitation Support (US$78.47 million). This component promotes the development of community capacities for planning and project management through support for sub-district technical and social facilitators and kabupaten (district) facilitators. It also includes activities to strengthen inter village organizations and forums and local government coordination and oversight.

Component 3: Implementation Support and Technical Assistance (US$41.75 million). This component provides implementation support, training and technical assistance at the national and provincial levels to manage the program and strengthen the capacity of local governments. A portion of the national level support will include assistance to aid in the strategy development for PNPM going forward. The component also covers the costs of PNPM-Rural’s monitoring and evaluation program. In addition, it includes an enhanced audit program that expands sampling, provides capacity development support for district government auditors, and sampling and provides capacity development support for district government auditors. This component also funds most project training other the community-level training.

Component 4: Project Management Support (US$29.96 million). PNPM’s special programs, which include pilot projects and government add-ons as well as crisis response activities (natural disasters, conflict, and financial), place several additional demands on normal government budgeting, particularly as the program is operating nationwide. Most of these operational costs will be covered by the Government through their national (APBN) and local budgets (APBD); a minimal amount is financed through the loan.

The local governments of Aceh, Papua and West Papua are capitalizing on the CDD approach and have linked their own development programs to PNPM-Rural.

(a) Aceh: PNPM-BKPG. In 2009, the Government of Aceh, as part of its village prosperity program (BKPG), allocated over US$100 million (approximately one-eighth of its provincial budget for the year) in block grants for 6,411 villages in 23 districts and 276 sub-districts. Planning and implementation of the funds are linked to PNPM-Rural’s (and PNPM-Urban’s for 411 of the villages) mechanisms and facilitators. PNPM-BKPG will continue in 2010, but with increased block grant funds from both PNPM as well as from the local provincial government for BKPG.

(b) Papua and West Papua: PNPM-RESPEK. In 2007, the local governments of Papua and West Papua launched a village development strategy (RESPEK) and allocated about US$40 million for block grant investment funds for every village and linked planning and implementation of these funds to PNPM-Rural, utilizing over 1,000 facilitators to support about 420 sub-districts.
and more than 4,000 villages. PNPM-RESPEK continued fully funded in 2009, and is expected to continue in tandem with PNPM-Rural through 2010 as well.

5. Financing

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6. Implementation

(i) Partnership arrangements

In addition to administering the PSF Trust Fund and co-chairing the JMC comprising GOI non-executing agencies and development partners contributing more than US$1 million to the PSF Trust Fund for PNPM, PNPM-Rural has benefited from generous support from bilateral development partners. Assistance has been especially helpful for piloting innovations that then get taken up by the larger program and for providing special assistance in difficult environments, such as Aceh, Nias, and Papua, as well as for conducting monitoring and evaluation activities.

(ii) Institutional and implementation arrangements

Tim Pengendali is the national oversight body of PNPM. Tim Pengendali is chaired by Menko Kesra and includes Bappenas, Finance, and the main line agencies that execute the component programs. In practice, Menko Kesra is responsible for overall policy guidance, Bappenas manages technical issues, including overall budget preparation and planning, Finance provides the budget, and the line agencies execute delivery to the villages.

Overall project oversight of PNPM-Rural III will remain the responsibility of the Ministry of Home Affairs (MOHA), while the day-to-day coordination is to be undertaken by a Project Management Unit (PMU), assisted by administrative units (Satkers). At the provincial level, PNPM-Rural III coordination and management will mirror the national level arrangement, with the governor in charge. Similarly, at the district level, the district heads (bupatis) will oversee poverty alleviation programs, including PNPM, and delegate this responsibility to sub-district heads (camats). Village heads play this role at the local level, in villages. At the lower administrative levels, coordination and decisions on sub-projects and funding of PNPM-Rural are carried out at inter-village consultations (MADs) and village assemblies (MDs).

For PNPM-Rural III, as for KDP and PNPM, consultants and facilitators will be employed to assist with coordination and implementation. The consultants and facilitators are employees of and managed by the National Management Consultant (NMC) team, which are firms contracted by GOI to oversee technical assistance provided to the project. These consultants and facilitators are charged with and responsible for the technical quality of the sub-projects selected for funding through the inter-village consultation and village assemblies. They report to the relevant Satkers at the respective levels of government (provincial, district, and sub-district). Each province participating in PNPM-Rural III will have a small Provincial Oversight Team, and in each district a team of at least three district facilitators (one engineer, one social organizer, one financial specialist and one or more assistants). Each participating sub-district will have a minimum of two facilitators (one social organizer and one field engineer plus a field assistant) directly working with sub-district officials and the villages and the project teams in each.
(iii) Monitoring and Evaluation of Outcomes/Results

PNPM-Rural has a comprehensive monitoring and evaluation (M&E) framework consisting of:

(a) Monitoring Activities:
- Community participatory monitoring
- Government supervision and monitoring
- Consultants’ internal monitoring
- Management information systems (MIS)
- Independent external monitoring by provincial NGOs
- Complaints handling and grievance redress mechanisms
- Financial supervisions and audits, both internal and external
- World Bank supervision missions

(b) Evaluation Activities:
- Impact evaluations for both PNPM-Rural and its pilot, PNPM-Generasi program.
- Thematic evaluations and studies including: technical quality and costs of services; economic analyses; sustainability; micro-finance reviews; environment; conflict prevention; gender; and local governance. These evaluations employ both quantitative and qualitative methodologies.

GOI has also formed two sub-working groups for M&E, one focused on finalizing target indicators for all PNPM, and another working group on MIS and reporting. PNPM M&E Operational Guidelines, which will apply to all programs under the PNPM umbrella are in place and will be further improved by MOHA in the areas of: (a) community and NGO monitoring; (b) complaints handling; (c) financial audits; (d) impact evaluations; and (e) thematic evaluations and studies.

As under previous projects, PNPM-Rural III will continue to support GOI in adopting and implementing strategic directions for the program and in addressing specific challenges to its effectiveness through a learning-by-doing approach. The project will support the piloting of design changes as part of implementation in some communities, which will be evaluated at mid-year review meetings hosted by Tim Pengandali (the national inter-ministerial oversight body of PNPM). At these semi-annual meetings, senior government officials and key stakeholders will agree on which pilots will be undertaken, the geographic areas for conducting them, and appropriate monitoring and evaluation metrics and methods. In addition, results from existing pilots will be reviewed and decisions will be made on whether to scale-up the pilots, make adjustments and continue testing, or discontinue.

7. Sustainability

The sustainability of PNPM-Rural/KDP has already been broadly demonstrated: strong community participation ensures local ownership and investments in demand-driven subprojects; local government participation provides additional support and ensures institutionalization of the process, enabling increased ability to scale-up; and village-level investments have been proven to be of high quality and more economical using a community-driven approach vis-à-vis traditional contracting. PNPM programs have already been scaled-up through successive operations that have built upon the successes and have expanded the geographic scope of previous operations. The scale-up of the programs has taken place in the context of institutional collapse, major economic crises, and during the implementation of one of the world's largest decentralization programs. The success of these programs in spite of the socio-political challenges faced highlights their potential for long-term sustainability and their flexibility to adapt to a changing environment.
With PNPM-Rural and its pilots, sectoral agencies at the local government level are becoming increasingly more involved in coordinating the implementation of complementary projects. For example, the Ministry of Marine Affairs and Fisheries, in an effort to reduce poverty occurring in 32 percent of the 16.4 million fishermen and coastal communities, launched in 2009 the National Program of Self-Supporting Marine and Fisheries Community Empowerment (PNPM-MKP). The program provides assistance for the development of marine fisheries and small scale businesses.

In order to ensure ownership and sustainability, in addition to the reorganization of the management of poverty alleviation efforts, local governments are required to provide a minimum of 20 percent of the block grant investment funds and an additional 6 percent for administration and oversight. For PNPM-Rural, provincial governments also manage all facilitators, including recruitment, training, contracting, salary payments and performance evaluations, with supervision from the central government’s PMU and its NMC in Jakarta.

In stages, over the last eleven years, efforts have been undertaken to better guarantee sustainability. What was begun under KDP and was taken up in 2006 with the launch of PNPM and expanded nationally in 2009 by the Government, has also been replicated by local governments in many locations (Papua and Aceh, to name but two). Larger amounts of the government’s own funds are going into CDD activities linked to PNPM. All this is evidence CDD in Indonesia is successful and sustainable.

8. Lessons Learned and Reflected in Project Design

The design of the first PNPM-Rural project incorporated multiple lessons learned from previous CDD operations around the world and in Indonesia – such as KDP. Moreover, its platform allows for a systematic “learning by doing approach”. Both have been instrumental in contributing to the project’s effective implementation, GOI’s buy-in, and visible impact to date. While there will be no significant changes in this project’s design, implementation refinements will be included in the new project, to address the following:

(a) **Revolving Funds.** While the revolving funds have had a positive impact in the ongoing project and earlier KDP projects, the current design is not sustainable and might over time have adverse effects on the availability of financial services for the poor. The new project will begin a gradual phasing out of revolving funds. This phasing out will be combined with the design and progressive build-up of more sustainable, independent access to financial services to the poor.

(b) **Audits.** Research has shown that high levels of participation and community oversight are not sufficient in monitoring the financial management of the project, and that expanded audits help reduce fraud and corruption. The project will: (a) expand and improve the intake of quality data; (b) strengthen the systems for responding to corruption, including through escalation mechanisms for issues that cannot or are not addressed appropriately at local levels; and (iii) improve transparency. For funds used in 2010 (and beyond) audits are expected to cover at least 20 percent of all sub-districts. The villagers of every sub-district will be informed in advance of the higher probability of being audited, and every village audited will hear directly the results of the audit immediately after the village is inspected. Audits will be carried out jointly by the State Internal Audit Commission (BPKP), and local district level inspectors (Bawasda).

(c) **Financial Management.** Facilitation and oversight by project consultants is essential to project success. Well trained facilitators and oversight consultants will be mobilized early and tasked with local supervision. Besides employing consultants dedicated to ensuring technical quality,
additional consultants will continue to be placed in each province to oversee the complaints handling systems and placed in each district for enhancing the supervision of financial management practices and to assist in the handling of revolving funds. The management of facilitators will continue to be delegated to provinces and management of block grants funds to district governments, but supervision and financial oversight of both will be increased.

(d) Disbursements. Delays in the issuance of annual budgets have negatively affected KDP/PNPM implementation and results. GOI has agreed to pre-finance all block grants, an agreed portion of which will then be reimbursed. This should eliminate most serious delays.

9. Safeguard Policies (including public consultation)

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10. List of Factual Technical Documents

(a) Project Manual  
(b) Training Plan  
(c) TOR for all positions  
(d) Audit TOR  
(e) Technical Design Manuals and field Guides  
(f) Better Governance Action Plan

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